

Message Text

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ACTION ARA-20

INFO OCT-01 ISO-00 DRC-01 AID-20 CIAE-00 COME-00 EB-11

FRB-03 INR-11 NSAE-00 RSC-01 TRSE-00 XMB-07 OPIC-12

SP-03 CIEP-03 LAB-06 SIL-01 OMB-01 NSC-07 SS-20

STR-08 CEA-02 L-03 H-03 PRS-01 PA-04 USIA-15 AGR-20

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R 111445Z SEP 74 ZEL
FM AMEMBASSY BRASILIA
TO SECSTATE WASHDC 5531
INFO AMCONSUL RIO DE JANEIRO
AMCONSUL SAO PAULO

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LINE OMITTED)

E. O. 11652: N/A

TAGS: EFIN, BR, EGEN

SUBJECT: ECONOMIC SITUATION REVIEWED BY FINANCE MINISTER SIMONSEN

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1. SUMMARY: FINANCE MINISTER SIMONSEN, IN A PRESENTATION
ON SEPTEMBER 4 BEFORE A CONGRESSIONAL COMMITTEE, REVIEWED
THE ECONOMIC SITUATION FOR THE FIRST SEVEN MONTHS AND THE
OUTLOOK FOR THE REST OF THE YEAR. HE SAID ALL INDICATIONS
ARE THAT THE GROWTH THIS YEAR WILL BE ON THE ORDER OF 10
PERCENT. HE CAUTIONED, HOWEVER, THAT THIS MAY NOT BE
POSSIBLE NEXT YEAR AS THE BALANCE OF PAYMENTS IS RAPIDLY
BECOMING A CONSTRAINT ON GROWTH. IN ANY CASE, HE STRESSED,
GROWTH WILL BE MAXIMIZED. BECAUSE OF THE BALANCE OF
PAYMENTS PROBLEMS BROUGHT ABOUT BY HIGHER OIL PRICES,
SIMONSEN NOTED THAT BRAZIL NEEDS TO CHANGE TO ECONOMIC
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PRIORITIES GIVING MORE EMPHASIS TO WATER TRANSPORTATION,

MASS TRANSIT AND RAILROADS. ON THE BALANCE OF PAYMENTS OUTLOOK, HE PREDICTED A TRADE DEFICIT OF \$3 TO \$4 BILLION AND A CURRENT ACCOUNT DEFICIT OF \$5 TO \$6 BILLION, BUT HE EXPECTED CAPITAL INFLOWS TO BE SUFFICIENT TO COVER THIS WITHOUT DIPPING INTO OFFICIAL RESERVES. DESPITE AN INCREASE OF \$4 TO \$5 BILLION THIS YEAR, HE DID NOT EXPECT THE FOREIGN DEBT TO CAUSE PROBLEMS FOR BRAZIL'S CREDIT STANDING. SIMONSEN ALSO REITERATED THE GOVERNMENT'S DESIRE TO IMPROVE REGIONAL AND PERSONAL INCOME DISTRIBUTION. END SUMMARY.

2. ECONOMIC GROWTH: SIMONSEN CONFIRMED THAT, DESPITE THE WORLDWIDE ECONOMIC SLOWDOWN WHICH HAS BROUGHT A CERTAIN INCREASE IN PROTECTIONISM, BRAZIL'S ECONOMY IN 1974 WILL GROW ON THE ORDER OF 10 PERCENT (REAL TERMS). HE EXPECTED INDUSTRIAL PRODUCTION TO INCREASE BY 11-12 PERCENT AND AGRICULTURAL PRODUCTION BY 8-10 PERCENT. DURING THE FIRST FOUR MONTHS OF 1974, COMPARED TO THE SAME PERIOD LAST YEAR, OUTPUT OF THE MANUFACTURING SECTOR WAS UP 14.3 PERCENT. DURING THE FIRST SEVEN MONTHS OF THE YEAR, MOTOR VEHICLE PRODUCTION INCREASED BY 24.4 PERCENT. DURING THE FIRST HALF, ELECTRICITY CONSUMPTION IN THE SOUTHEASTERN REGION ROSE BY 14.2 PERCENT. SIMONSEN SAID IT WOULD BE IMPRUDENT TO MAKE ANY PREDICTIONS FOR 1975, GIVEN THE PRESENT UNCERTAINTY OF THE WORLD ECONOMIC SCENE. HE CONTINUED, HOWEVER, THAT THE GREAT CHALLENGE TO BRAZILIAN AUTHORITIES DURING THE NEXT FEW YEARS IS TO RECONCILE THE MAINTENANCE OF HIGH RATES OF REAL GROWTH WITH RELATIVE EQUILIBRIUM IN THE BALANCE OF PAYMENTS. HE DEFINED BRAZIL'S BASIC STRATEGY AS ONE DESIGNED TO REACH THE MAXIMUM POSSIBLE GROWTH COMPATIBLE WITH THE RESTRAINTS OF THE EXTERNAL SECTOR.

3. ECONOMIC POLICIES: TO ACHIEVE MAXIMUM GROWTH WITH BALANCE OF PAYMENTS CONSTRAINTS, SIMONSEN SET OUT A NUMBER OF UNDERLYING PRINCIPLES: LIMITED OFFICIAL USE

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(A) GIVEN THE PRESENT CONDITIONS, THE MOST NATURAL PRIORITIES ARE THE TWIN OBJECTIVES OF IMPORT SUBSTITUTION AND EXPORT EXPANSION. IN THE IMPORT SUBSTITUTION AREA, THE PRIORITY SECTORS ARE STEEL, PETROLEUM, NON-FERROUS METALS, CHEMICALS, FERTILIZERS AND CAPITAL EQUIPMENT;
(B) EXPORT EXPANSION IS PREFERABLE TO IMPORT SUBSTITUTION, EVEN THROUGH THE BALANCE OF PAYMENTS

IMPACT IS THE SAME. THE REASON
FOR THIS IS THAT FOREIGN DEBT CAPITAL IS
USUALLY MEASURED IN TERMS OF EXPORTS AND DEBT
OUTSTANDING; (C) THE RELATION BETWEEN THE FOREIGN
DEBT AND EXPORTS MUST BE KEPT WITHIN THOSE
LIMITS WHICH PRESERVE BRAZIL'S EXCELLENT
INTERNATIONAL CREDITWORTHINESS. IT IS ALSO
ESSENTIAL FOR BRAZIL TO MAINTAIN A HIGH LEVEL
OF RESERVES TO PROTECT THE BALANCE OF PAYMENTS
IN CASE OF UNDORESEEN DIFFICULTIES IN FOREIGN
TRADE OR IN THE INTERNATIONAL MONEY MARKET;
(D) THE ANNUAL BALANCE OF PAYMENTS DEFICIT ON CURRENT
ACCOUNT SHOULD BE CONTAINED WITHIN THE MAXIMUM LIMIT
OF 20 PERCENT OF GROSS CAPITAL FORMATION; AND (E)
THE OIL CRISIS REQUIRES A COMPLETE REVISION OF BRAZIL'S
TRANSPORTATION POLICY, BY GIVING GREATER
EMPHASIS TO RAILROADS, MASS TRANSIT AND
WATER TRANSPORTATION. HE CAUTIONED, HOWEVER,
THAT THIS SHOULD NOT BE DONE BY INFLICTING A
"SHOCK" TO THE AUTOMOBILE INDUSTRY BUT BY
DIRECTING MORE OF AUTO PRODUCTION, WHICH IS
INTERNATIONALLY COMPETITIVE, TO THE EXPORT MARKET.

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4. INFLATION: THE PRIMARY IMPACT ON BRAZIL OF THE INTERNATIONAL ECONOMIC SITUATION, SIMONSEN NOTED, WAS THE WORSENING OF DOMESTIC INFLATIONARY PRESSURES IN THE FIRST HALF OF 1974. HE ATTRIBUTED THE DOMESTIC PRESSURES OF THE FIRST HALF TO EXCESS DEMAND CAUSED BY THE LARGE INCREASE IN THE MONEY SUPPLY LAST YEAR (46.8 PERCENT). ADDED TO THIS DOMESTIC PRESSURE WAS THE ABNORMAL INCREASE IN IMPORT PRICES, WHICH DURING THE FIRST SEVEN MONTHS WERE UP 64 PERCENT (AVERAGE DOLLAR PRICES) OVER THE SAME PERIOD OF 1973. TO CONTROL INFLATION, SIMONSEN SAID THE AUTHORITIES HAVE FOLLOWED A POLICY OF LIMITING THE EXPANSION OF THE MONEY SUPPLY WHILE HOLDING THE BUDGET IN CURPLUS. THE MONEY SUPPLY EXPANSION OF 9:93 PERCENT THROUGH JULY WAS ONLY .03 PERCENT ABOVE THE ESTIMATES MADE IN THE MONETARY BUDGET. WITH THE GOVERNMENT BEING A NET LENDER TO THE MARKET, THE MONEY

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SQUEEZE ON THE PRIVATE SECTOR WAS NOT AS BAD AS IT MIGHT OTHERWISE HAVE BEEN. THE MINISTER EXPECTED A TAPERING OFF OF INFLATION IN THE REMAINING MONTHS OF 1974 (THE GUANABARA COST-OF-LIVING INDEX WAS UP 23.1 PERCENT THROUGH JULY) AND PREDICTED A RATE OF INFLATION OF 32 PERCENT FOR THE ENTIRE YEAR. HE REITERATED THAATT WITH A SYSTEM OF MONETARY CORRECTION AND A CRAWLING PEG RATE OF EXCHANGE BRAZIL CAN NEUTRALIZE THE IMPACT OF THIS INFLATION ON THE ECONOMY.

5. BALANCE OF PAYMENTS AND FOREIGN DEBT:
LIKE VIRTUALLY ALL OTHER OIL-IMPORTING COUNTRIES, BRAZIL'S MAIN BALANCE OF PAYMENTS PROBLEM IN 1974 IS A DEFICIT ON TRADE AND CURRENT ACCOUNTS. DURING THE FIRST SEVEN MONTHS, EXPORTS (FOB) AMOUNTED TO \$3.7 BILLION WHILE IMPORTS REACHED \$6.7 BILLION, LEAVING A TRADE DEFICIT OF \$3.0 BILLION. ALTHOUGH EXPORTS SHOULD PICK UP DURING THE REST OF THE YEAR, WHICH IS REASONABLY THE CASE, AND IMPORTS DROP OFF A BIT AS A RESULT OF RECENTLY-ADOPTED RESTRICTIVE MEASURES, SIMONSEN PREDICTED A TRADE DEFICIT IN THE \$3 TO \$4 BILLION RANGE FOR 1974, AND A CURRENT ACCOUNT DEFICIT IN THE \$5 TO \$6 BILLION RANGE. HE ALSO SAID THAT IT IS FORESEEN THAT THIS DEFICIT WOULD BE FINANCED WITH NEW CAPITAL INFLOWS SO THERE WOULD BE NO NEED TO DIP INTO RESERVES. HE DORESAAW A \$4 TO \$5 BILLION INCREASE

IN THE NET FOREIGN DEBT (WHICH IS THE GROSS DEBT MINUS RESERVES), SINCE ABOUT \$1 BILLION OF THE NEEDED CAPITAL IS EXPECTED TO TAKE THE FORM OF DIRECT INVESTMENTS WHICH DO NOT AFFECT THE FOREIGN DEBT POSITION.

6. SIMONSEN SAID THESE FIGURES SHOULD NOT BE A CAUSE OF SERIOUS CONCERN SINCE 1974 IS QUITE DIFFERENT FROM 1973. HE INDICATED BRAZIL WILL REACH THE END OF THE YEAR WITH A NET DEBT THE EQUIVALENT OF 18 MONTHS OF EXPORTS, WHICH, HE SAID, REPRESENTS A SATISFACTORY COEFFICIENT OF INTERNATIONAL SOLVENCY, FURTHERMORE, HE ADDED, BRAZIL HAS A FAVORABLE DEBT STRUCTURE AND A GOOD SAFETY VALVE IN A RESERVE LEVEL OF \$6.4 BILLION.

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7. INCOME DISTRIBUTION: SIMONSEN STRESSED AGAIN THAT IMPROVED REGIONAL AND PERSONAL INCOME DISTRIBUTION IS A MAJOR POLICY OBJECTIVE OF THE GOVERNMENT. BUT, HE SAID, THIS GOAL SHOULD BE ACHIEVED THROUGH TECHNICALLY CORRECT WAYS SO AS NOT TO JEOPARDIZE ECONOMIC DEVELOPMENT. WITH RESPECT TO REGIONAL INCOME DISTRIBUTION, HE EXPECTS THE GOVERNMENTS TO CONTINUE THE PRESENT FISCAL INCENTIVE PROGRAMS AND OTHER SCHEMES. HE CONFIRMED THAT THE GOVERNMENT IS STUDYING THE POSSIBILITY OF SETTING UP PARTICIPATION FUND (FORM OF REVENUE SHARING) OF ICM (THE STATE-LEVEL ADDED VALUE TAX) REVENUES AS A MEANS TOWARD BETTER REGIONAL INCOME DISTRIBUTION.

8. WITH RESPECT TO IMPROVING INCOME DISTRIBUTION, HE SAID IT WOULD BE INGENUOUS TO EXPECT TO ACHIEVE IT BY THE MERE PASSAGE OF LEGISLATION. HE STRESSED THAT THE BEST WAY OF DOING THIS IS BY STIMULATING ECONOMIC GROWTH, INCREASED EDUCATIONAL OPPORTUNITIES, BETTER HEALTH SERVICES FUNDS ON BEHALF OF THE WORKERS (SUCH AS THE SOCIAL INTEGRATION FUND). END UNCLASSIFIED

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9. COMMENT: SIMONSEN'S PRESENTATION THIS TIME WAS CONSIDERABLY MORE PESSIMISTIC THAN THE ONE HE DELIVERED BEFORE THE SENATE ABOUT TWO MONTHS AGO (REFTEL). THIS MAY BE PART OF A GOVERNMENT CAMPAIGN TO PREPARE THE PUBLIC FOR SOME DOWNTURN IN THE GROWTH RATE NEXT YEAR, TO SOMETHING WELL BELOW THE 9-10 PERCENT GROWTH OF THE LAST 4-5 YEARS BY SETTING FORTH IN REALISTIC TERMS THE CURRENT IMPEDIMENTS TO CONTINUING HIGH GROWTH - RESURGENCE OF BALANCE OF PAYMENTS CONSTRAINTS, DOMESTIC INFLATION, SHORTAGES OF

ESSENTIAL MATERIALS, AND REPERCUSSIONS OF A WORLD
ECONOMIC SLOWDOWN. END LIMITED OFFICIAL USE

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10. DURING HIS PRESENTATION BEFORE THE CONGRESSIONAL
COMMITTEE, SIMONSEN MENTIONED THAT PER CAPITA NATIONAL
PRODUCT IN BRAZIL HAS NOW REACHED U.S. \$770, THAT
FIGURE WAS APPARENTLY BASED ON A REVISED 1973 GNP
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ESTIMATE OF 473 BILLION CRUZEIROS (ROUGHLY U.S.
\$77 BILLION) RELEASED AT THE END OF AUGUST BY THE
GETULIO VARGAS FOUNDATION. THE RELEASE, WHICH ONLY
GAVE PARTIAL DATA, ALSO ANNOUNCED A FIGURE OF 382.6
BILLION CRUZEIROS FOR NET DOMESTIC PRODUCT AT FACTOR
COST IN 1973. THE REVISED ESTIMATES FOR 1972 WERE
355.8 BILLION CRUZEIROS FOR GNP AND 289.2 BILLION
CRUZEIROS FOR NDP AT FACTOR COST. ASSUMING A PRICE
DEFLATOR OF 17 PERCENT, THESE FIGURES IMPLY REAL
GROWTH DURING 1973 OF ABOUT 10.4 PERCENT.
CRIMMINS

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